FILED
JAN 3 1977
MICHAEL RODAK, JR., CLERK

Supreme Court of the United States

October Term, 1976

No. 76-751

KOEHLER MANAGEMENT CORP., GERALD KOEHLER, ROGER BENHAM, WILLIAM J. EISENHAUER, PAUL M. GILLMOR, MARTIN A. JANIS, ROBERT B. JOHNSTON, RAY W. MOLDER, ALFRED E. RHODEN, M. D., GILBERT H. SIEGEL, RAY L. VISCHER, Estate of JOSEPH A. SCHUSTER, Deceased,

Petitioners,

vs.

CHARLES NICKELS and MARGARET NICKELS on Behalf of Themselves and All Other Shareholders of Koehler Management Corporation,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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TABLE OF CONTENTS

Reasons for Denying the Writ 1

I. There Is No Conflict Between the Decision of the Sixth Circuit in Nickels and the Decisions of Other Circuits 1

II. The Petitioners Have Not Set Forth Any Good Reasons to Overturn the Established Law on This Issue in the Sixth Circuit 6

III. Adoption of Statutes of Limitations Found in Other Sections of the Federal Securities Act Would Create Uncertainty in the Law 9

Conclusion 10

TABLE OF AUTHORITIES

Cases

Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972) 8

Charney v. Thomas, 372 F.2d 97 (6th Cir. 1967) 2, 3, 4, 6, 7, 9

Clegg v. Conk, 507 F.2d 1351 (10th Cir. 1974), *cert. denied*, 422 U.S. 1007, 95 S. Ct. 2628, 45 L.Ed.2d 669 (1975) 9

Connelly v. Balkwell, 279 F.2d 685 (6th Cir. 1960) 6, 7

Douglas v. Glenn E. Hinton Investment, Inc., 440 F.2d 912 (1971) 9-10

Ernest and Ernest v. Hochfelder, ... U.S. ....., 47 L.Ed.2d 668, 96 S. Ct. ..... (1976) 7-8

Hudak v. Economic Research Analysts, Inc., 499 F.2d 996 (5th Cir. 1974), *cert. denied*, 419 U.S. 1122, 95 S. Ct. 805, 42 L.Ed.2d 821 (1975) 2, 4, 5, 6, 8, 9

IDS Progressive Fund, Inc. v. First of Michigan Corporation, 533 F.2d 340 (6th Cir. 1976) 7, 9
Janigan v. Taylor, 344 F.2d 781 (1st Cir. 1965) 9
John Hopkins University v. Hutton, 488 F.2d 912 (4th Cir. 1973) 9
Klein v. Shields & Co., 470 F.2d 1344 (2nd Cir. 1972) .. 9
Kubik v. Goldfield, 479 F.2d 472 (3rd Cir. 1973) 9
Parrent v. Midwest Rug Mills, Inc., 455 F.2d 123 (7th Cir. 1972) 2, 3, 4, 5, 6, 9
S. E. C. v. Coffey, 493 F.2d 1304 (6th Cir. 1974) 5
Trussell v. United Underwriters Ltd., 228 F. Supp. 757 (1964) 3
United California Bank v. Salik, 481 F.2d 1012 (9th Cir. 1973), *cert. denied*, 414 U.S. 1004 (1973) 7, 8, 9
Vanderboom v. Sexton, 422 F.2d 1233 (8th Cir. 1970) 2, 4, 6, 9

Statutes

Ark. Stat. Ann. Sections 67-1235 through 1262 2
Ark. Stat. Ann. Section 67-1256 (Replacement 1966) 2
Mich. Stat. Ann. Sec. 19.760; Comp. Laws 1948, Section 451.120 3
Ohio Revised Code, Section 2305.09 ..... 6, 7
Ohio Revised Code, Section 1707.43 8
Ohio Revised Code, Section 1707.01, et seq. 8
Securities Act of 1933, 15 U.S.C. Section 77(l) (2) 2
Securities Act of 1933, 15 U.S.C. Section 12(2) 2
Uniform Securities Act, Section 410 2

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BRIEF FOR RESPONDENTS IN OPPOSITION

REASONS FOR DENYING THE WRIT

I. There Is No Conflict Between the Decision of the Sixth Circuit in Nickels and the Decisions of Other Circuits.

The first reason given by the petitioners in the petition regarding why this Court should hear this case is that the decision of the Sixth Circuit below is in conflict with

the decisions of other circuits. A reading of the decisions cited by the petitioners shows that there are significant differences between those cases and the present case. An understanding of those differences is essential to understanding why there is, in reality, no conflict between the decision of the Sixth Circuit in this case and the decisions cited by the petitioners. The cases involving 10b-5 actions cited by the petitioners are, from the Fifth Circuit, *Hudak v. Economic Research Analysts, Inc.*, 499 F.2d 996 (1974); from the Seventh Circuit, *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123 (1972); and, from the Eighth Circuit, *Vanderboom v. Sexton*, 422 F.2d 1233 (1970).

Of these, the first one to apply a statute of limitations found in a state blue sky statute was *Vanderboom v. Sexton*, 422 F.2d 1233 (Eighth Circuit—1970). That case arose in Arkansas and involved a choice between the Arkansas statute of limitations for blue sky actions and a general statute of limitations which has been made applicable to fraud. In that case, the Federal District Court for the Western Division of Arkansas had applied the statute of limitations found in Arkansas' blue sky law (Ark. Stat. Ann. Sections 67-1235 through 1262). The particular section of Arkansas' blue sky law involved in the case was Ark. Stat. Ann. Sec. 67-1256 (Replacement 1966). This statute is Section 410 of the Uniform Securities Act. Section 410 is modeled after and parallels Section 12(2) of the Securities Act of 1933, 15 U.S.C. Section 77(1) (2). The limitation period in this section is two years; and, as a result, the plaintiffs' claim was barred. On appeal the plaintiffs argued that the proper statute of limitations to apply was that statute applicable to action for fraud because Rule 10b-5 and Section 67-1256 of the Arkansas blue sky statute were not identical. The appellant cited to *Charney v. Thomas*, 372 F.2d 97 (Sixth Circuit—1967), in which the Sixth Circuit in a Michigan case

had held that the proper statute in 10b-5 actions was the Michigan statute of limitations applicable to actions for fraud and not the statute of limitations found in Michigan's blue sky laws (Mich. Stat. Ann. Sec. 19.760; Comp. Laws 1948, Sec. 451.120). The appellants also cited to a case from the Federal District Court in Colorado: *Trussell v. United Underwriters Ltd.*, 228 F. Supp. 757 (1964), in which the Court had rejected the application of a state blue sky statute of limitations and had applied the state statute of limitations governing actions for fraud. The Eighth Circuit, however, applied the Arkansas blue sky statute and distinguished the cases cited by the appellant by reasoning that the basis for the decisions in *Charney* and *Trussell* was that those courts construed Rule 10b-5 as requiring scienter and, thus, basically analogous to common law fraud. The Court pointed out that the rule in the Eighth Circuit was that Rule 10b-5 applied to negligent, as well as intentional, misrepresentations and then held that the statute of limitations found in Arkansas' blue sky law should be applied. Consequently, the Eighth Circuit stated that this called for a shorter limitation period on the federal claim (422 F.2d 1239). A close reading of the opinion shows that this was the most important factor in its decision, although the Court did mention other factors, such as a commonalty of purpose between Rule 10b-5 and the Arkansas blue sky statute and the same lack of defense under Rule 10b-5 and the Arkansas statute.

The next Circuit Court of Appeals to hold that a state blue sky statute of limitation should be applied in a Rule 10b-5 case was the Seventh Circuit in *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123 (1972). In that case, which arose in Illinois, the Seventh Circuit applied the statute of limitations found in the Illinois blue sky law. In its opinion, the Seventh Circuit cited to *Charney*

and *Vanderboom* as holding that in 10b-5 actions the statute of limitations for the statute most closely resembling Rule 10b-5 should be applied (455 F.2d 126). The Seventh Circuit then stated that the divergent results of the two cases could be explained by the differing interpretation of Rule 10b-5 in the Sixth and Eighth Circuits. The Seventh Circuit looked upon *Charney* as holding that in Rule 10b-5 actions the plaintiff must prove scienter while the Eighth Circuit in *Vanderboom* read Rule 10b-5 in a broader sense, holding that negligent, as well as intentional, conduct was actionable under Rule 10b-5. The Seventh Circuit then stated that it agreed with the Eighth Circuit's interpretation of Rule 10b-5 and held that the statute of limitations contained in the Illinois blue sky statute should be applied (455 F.2d 126). Although the Seventh Circuit did not express it clearly in its opinion, it is obvious from a reading of the opinion that it did agree with the Eighth Circuit that Rule 10b-5 covers negligent, as well as intentional, acts.

The final Circuit Court of Appeals opinion involving Rule 10b-5 cited by the petitioners is the opinion of the Fifth Circuit in *Hudak v. Economic Research Analysts, Inc.*, 499 F.2d 996 (1974). In *Hudak*, a Florida case, the Fifth Circuit chose to apply a blue sky statute of limitations. In so doing, the Court stated that: "We concur in the reasoned judgment of the Seventh and Eighth Circuits which, when faced with the present choice . . . found the similarity between the blue sky and 10b-5 scienter requirements crucial to their decisions." (499 F.2d 1000). As in *Vanderboom* and *Parrent*, the opinion in *Hudak* reflects the relationship between the decision to lower the standard of culpability required for a 10b-5 violation and the decision to choose the shorter state statute of limitations. This relationship exists because implicit in the opinions of the Fifth, Seventh, and Eighth

Circuit Courts of Appeals is the belief that statutes of limitations governing lawsuits based upon non-culpable conduct should be shorter than those governing lawsuits based upon culpable conduct. Historically this has been true in American jurisprudence. The reason that longer statutes of limitations govern intentional wrongdoing is to be certain that such tortfeasors are forced to compensate their victims. Short statutes of limitations would work against the exposure of these wrongdoers to suit.

Unlike the Seventh and Eighth Circuits, the Sixth Circuit had never held a purely negligent tortfeasor to be accountable under Rule 10b-5. In *S. E. C. v. Coffey*, 493 F.2d 1304 (1974), the Sixth Circuit stated that non-culpable conduct would not constitute Rule 10b-5 violation ". . . since Section 106 of the 1934 Act does not impose liability for negligent acts but only for acts of fraud and deceit." (493 F.2d 1304). Since the Sixth Circuit had always regarded Rule 10b-5 violations as fraudulent acts requiring scienter, the policy considerations which had led the other circuits to impose a relatively short statute of limitations were not present in this case. Besides the difference between the Fifth, Seventh, and Eighth Circuits and the Sixth Circuit on the issue of the necessity of scienter in Rule 10b-5 violations, another difference exists between this case and the opinions in *Parrent* and *Hudak*. The language of the blue sky statutes involved in those two cases was virtually identical to the language of Section 10 (B) and Rule 10b-5. A reading of those opinions shows that those Courts were influenced by that fact. *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123, 127; and *Hudak v. Economic Research Analysts, Inc.*, 499 F.2d 996, 1000. The Ohio blue sky statutes, while perhaps similar to Section 10 (B) and Rule 10b-5, are not so similar as to be said to parallel Section 10 (B) and Rule 10b-5.

Understanding the rationale of the decisions of the Fifth, Sixth, Seventh, and Eighth Circuits, it at once becomes apparent that the "conflict" which petitioners allege exists is a result of the different interpretations put upon Rule 10b-5 by those circuits. The opinions of the Seventh and Eighth Circuits in *Parrent* and *Vanderboom* make it clear that had these circuits regarded Rule 10b-5 as covering only intentional or fraudulent acts then they would have chosen the state statute of limitations for actions based on fraud. The opinion of the Fifth Circuit in *Hudak* shows that that circuit also regarded its determination that Rule 10b-5 encompasses a lesser standard of culpability than does fraud as being crucial to its decision to choose the Florida statute covering blue sky violations.

II. The Petitioners Have Not Set Forth Any Good Reasons to Overturn the Established Law on This Issue in the Sixth Circuit.

In 1960 the Sixth Circuit affirmed in *Connelly v. Balkwell*, 279 F.2d 685, an opinion of the Federal District Court for the Northern District of Ohio. The Federal District Court had held that the state statute of limitations to be applied in a private action based on Rule 10b-5 was the statute of limitations found in Section 2305.09 of the Ohio Revised Code. That case did not involve a choice between that statute of limitations and the one found in the Ohio securities law. Seven years thereafter, however, the Sixth Circuit again had the opportunity to consider the statute of limitations issue. *Charney v. Thomas*, 372 F.2d 97 (1967), did involve a choice between applying the six-year Michigan limitations for fraud and a two-year limitation found in the state blue sky law. In *Charney*, the Sixth Circuit held that the Michigan blue sky

statute did not contain a provision similar to Rule 10b-5 and, therefore, that the statute of limitations to be applied was the one governing fraud actions. As a result of these two cases, parties in Ohio had reason to believe that the proper statute of limitations to be applied in a Rule 10b-5 case was the one found in Ohio Revised Code Section 2305.09. Although it is true that *Connelly* did not involve the same issues as the present case, nevertheless, the two cases, when taken together, constitute the law governing Rule 10b-5 cases in Ohio.

Most recently, in *IDS Progressive Fund, Inc. v. First of Michigan Corporation*, 533 F.2d 340 (Sixth Circuit—1976), the Sixth Circuit held that "[f]or us to change the applicable limitations period without good cause would add an unnecessary uncertainty to the prosecution of federal claims under Section 10 (B)." (533 F.2d 343). Consequently, the Court refused to apply the new Michigan blue sky limitations contained in the Uniform Securities Act, which limitations had been adopted in place of the earlier blue sky law considered in *Charney*. The Court also held that: "The broad remedial purposes of the federal securities laws are best served by a longer, not a shorter, statute of limitations." [533 F.2d 344, quoting *United California Bank v. Salik*, 481 F.2d 1012 (Ninth Circuit—1973), *cert. denied*, 414 U.S. 1004 (1973)]. Obviously, the same policy reasons for not adopting the state statute of limitations urged by the petitioners are present in this case. What "good cause" exists in this case to justify overturning the *precedent* in the Sixth Circuit?

The petitioners argue that the decision below is in conflict with the decision of other circuits and should be reversed by this Court. That "conflict", however, as shown above, does not, in reality, exist. Indeed, since the decision of this Court in *Ernest and Ernest v. Hoch-*

felder,..... U.S....., 47 L.Ed.2d 668, 96 S. Ct. ..... (1976), the underlying rationale of the decisions cited by the petitioners no longer exists. Also, as noted earlier, the present case is unlike *Hudak*, which involved a statute that is virtually identical to Section 10 (B) and Rule 10b-5.

What is really important, however, is not what the statute looks like but which statute best effectuates the federal policy behind Rule 10b-5. The petitioners argue that the statute of limitations found in Ohio Revised Code Section 1707.43 best effectuates the federal policy of Section 10 (B) and Rule 10b-5. In the section of their petition covering that issue, however, they never really state how the statute of limitations found in Section 1707.43 best effectuates federal policy. Most of that section alleges that Section 1707.01, et seq., most resembles Section 10 (B) and Rule 10b-5. As the Sixth Circuit observed in the case below, however, in Ohio an action based on common law fraud is very similar to an action based on Rule 10b-5. The Sixth Circuit noted that both the Ohio blue sky statute and Ohio actions for common law fraud ". . . bear a marked resemblance to 10b-5, but neither is identical with it." (page A15 of the Appendix Opinion of *Nickels v. Koehler Management Corporation*). As this Court noted in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), the federal securities act serves a "broad remedial purpose". This purpose is complemented by private actions for Rule 10b-5 violations. By choosing the fraud statute of limitations, the Sixth Circuit encourages the filing of Rule 10b-5 actions and increases the deterrent aspects of private litigation under Rule 10b-5. This conclusion was also reached by the Ninth Circuit in *United California Bank*.

III. Adoption of Statutes of Limitations Found in Other Sections of the Federal Securities Act Would Create Uncertainty in the Law.

The last reason given by the petitioners for this Court to hear this case is that the federal policy underlying the implied remedy of Section 10 (B) and Rule 10b-5 would be best effectuated by applying the statute of limitations found in other parts of the Federal Securities Act. The argument in this section of the petition is that the use of statutes of limitations contained in other parts of the Federal Securities Act would prevent "unfairness" to plaintiffs (allegedly resulting from differences between the various circuits) and would be more in keeping with the intent of Congress. As the Sixth Circuit noted in *IDS Progressive*, every Circuit Court of Appeals that has considered the issue has applied a state statute of limitations in a Rule 10b-5 action. See *Janigan v. Taylor*, 344 F.2d 781 (First Circuit—1965); *Klein v. Shields & Co.*, 470 F.2d 1344 (Second Circuit—1972); *Kubik v. Goldfield*, 479 F.2d 472 (Third Circuit—1973); *John Hopkins University v. Hutton*, 488 F.2d 912 (Fourth Circuit—1973); *Hudak v. Economic Research Analysts, Inc.*, 499 F.2d 996 (Fifth Circuit—1974), *cert. denied*, 419 U.S. 1122, 95 S. Ct. 805, 42 L.Ed.2d 821 (1975); *Charney v. Thomas*, 372 F.2d 97 (Sixth Circuit—1967); *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123 (Seventh Circuit—1972); *Vanderboom v. Sexton*, 422 F.2d 1233 (Eighth Circuit—1970); *United California Bank v. Salik*, 481 F.2d 1012 (Ninth Circuit), *cert. denied*, 414 U.S. 1004, 94 S. Ct. 361, 38 L.Ed.2d 240 (1973); *Clegg v. Conk*, 507 F.2d 1351 (Tenth Circuit—1974), *cert. denied*, 422 U.S. 1007, 95 S. Ct. 2628, 45 L.Ed.2d 669 (1975). For this Court to now hold that state statutes of limitations should not be applied would cause great uncertainty to litigants and their counsel. As the Ninth Circuit wrote in *Douglas v. Glenn E. Hinton Investment*,

Inc., 440 F.2d 912 (1971): "Reasonable stability in laws pertaining to voluntary relationships between parties, and the right of access to the courts to question those relationships, is a worthwhile objective." (440 F.2d 916).

There may be a theoretical appeal to commentators in choosing statutes of limitations found in other parts of the Federal Securities Act; but, in the everyday world of commerce, stability in the law, as noted by the Ninth Circuit, is very necessary. If this Court were to make such a change, it would only lead to greater confusion in this area. The agent for such a change, if such a change is desirable, is Congress. It would have the advantage of being able to secure a great many opinions and to express its true intent in this area. Just as importantly, the public would be aware of the effect of such a change and would be able to plan accordingly. Finally, action by Congress to change the limitation period would avoid litigation as to the effective date of such change and as to the effect of such change on pending actions.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be denied.

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